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IN THE

Supreme Court of the United States

October Term, 1957.

No. 130.

FIDELITY-PHILADELPHIA TRUST COMPANY
and
ROBERT B. HAINES, III,
Executors of the Will of Mary H. Haines, Deceased,
Petitioners,

v.

FRANCIS R. SMITH,
Collector of Internal Revenue,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

Reply Brief for the Petitioners.

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REPLY BRIEF FOR THE PETITIONERS.

RESPONDENT MISCONSTRUES PETITIONERS' ARGUMENT AND OBSCURES THE ISSUE.

1. Respondent Misconstrues Petitioners' Argument.

At page 8 of respondent's brief it is stated:

"Taxpayers' argument rests entirely on the premise, rejected by this Court in *LeGierse*, that a single purchase of a combined insurance-annuity contract of the kind here involved is to be viewed for estate tax pur-

> poses as if it constituted two separate and unrelated investments."

Again, at page 26 respondent's brief states:

> "Taxpayer's entire argument proceeds on the hypothesis, repudiated by this Court in *LeGierse* and *Goldstone*, that decedent's conjoined insurance-annuity purchase is to be treated as two separate and unrelated purchases, and that the total premium should be allocated as between the insurance and annuity features."

Quite to the contrary, petitioners concede—and believe this is clear in their main brief—that Mrs. Haines' purchase of each life insurance policy and annuity contract [1] constituted a single investment. However, it cannot be denied that the investment once made was thereafter divisible and, in fact, was divided when Mrs. Haines assigned the life policies (R. 6a-8a).

2. Respondent's Brief Obscures the Issue.

To focus on the issue it seems best to put two questions. Both must be answered affirmatively, if the opinion below is to be sustained. First, did the annuity constitute *income* from that part of the investment represented by the cash surrender value of the life policy? Second, how could Mrs. Haines have *retained* for the statutory life period,[2] *i.e.*, had a legal right to, the income from such cash surrender value when such cash surrender value was *wholly* owned by the assignees while she was alive? Petitioners contend both questions require a negative answer and, therefore, that Section 811(c)(1)(B) is not applicable to this part of the investment.

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1. Although decedent purchased three life insurance policies and three annuity contracts, in the interest of simplicity this brief on occasions will refer to the transactions as though there were a purchase of one life insurance policy and one annuity contract.

2. That is, for her life or for any period which did not in fact end before her death. I. R. C. of 1939, Sec. 811(c)(1)(B).

Respondent's brief omits two facts bearing on the first question, namely, that (1) Mrs. Haines, or anyone her age, could have purchased the very same annuity contracts at the prices Mrs. Haines paid for them without buying any life insurance at all (R. 5a); and, even more important, (2) if the assignees of the life insurance policies had cashed them in—as they had every right to do—the annuities would have continued undiminished until Mrs. Haines' death (R. 6a). How in these circumstances, petitioners ask, can the annuities be considered income from these cash surrender amounts which might have disappeared, leaving the annuities unchanged?

As to the second question, Mrs. Haines assigned the life policies many years before she died (R. 3a-8a). The assignments in reality effected two gifts: (1) a present and unqualified right in the assignees to enjoy *at the time of assignment* that part of the investment consisting of the cash surrender values;[3] and (2) a second conditional right, to be *enjoyable in the future* at Mrs. Haines' death, to receive the excess of the face amount of the insurance over the prior-to-death cash surrender values, provided the assignees did not cash in the policies during Mrs. Haines' life. Since the first gift belonged in its entirety to the assignees during Mrs. Haines' life, it is at variance with the facts to say that she had a retained income interest in it.

Respondent argues to the contrary. But, as noted, he ignores critical facts and there is a conspicuous gap in his argument. He altogether shuns discussion of the statutory word "retained" notwithstanding that its meaning is critical here. Obviously, the word "retained" in the statute (Section 811(c)(1)(B)) means retained in the sense of having a legal right to the income. To read it otherwise would make a travesty of the statute. It would be preposterous to say that a father who gave $10,000 cash outright

3. This gift was augmented during Mrs. Haines' life by the annual increases in the cash surrender values up to the amount of them just before her death (R. 10a-11a, 27, 40, 54).

to his daughter "retained" the income from such cash. It would be equally preposterous to say that Mrs. Haines *retained* the income from the original cash surrender amounts.[4]

If the assignees had surrendered the life policies—as they had every right to do (R. 6a-8a, 27, 40, 54, 77)—and invested the cash in stocks, dividend income therefrom would have been theirs. Even respondent, it is believed, would not claim that Mrs. Haines retained any legal or other right to this dividend income. Did the assignees' failure to take their cash[5] alter the situation so that, by some legerdemain, Mrs. Haines then had retained—legally owned—the income from such cash? Of course not. All such income was owned by the assignees and none was *retained* by Mrs. Haines. Such income consisted of the dividends on the life policies and also, it is submitted, is reflected in the annual increases in the cash surrender values (R. 27, 40, 54).[6]

The lower courts sustain petitioners' view. They hold that, for the purposes of Section 811(c), a decedent has "retained" the income from transferred property if, *and only if*, he has an enforceable legal right to it. In *Estate of Louis Richards v. Commissioner*, 20 T. C. 904 (1953) affirmed *per curiam* 221 F. 2d 808 (C. A. 9, 1955), a trustee of an irrevocable trust permitted the settlor to receive the trust income. For this reason the Commissioner of Internal Revenue argued that the trust corpus was includible in the settlor's gross estate as a transfer in respect of which he had retained the income for life. The Tax Court disagreed since the decedent had no legal right to the trust income, saying (at page 916):

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4. And it is also wrong to say that Mrs. Haines *retained*, for the statutory life period, the income from the increases in the cash surrender values since these increases belonged in their entirety to the assignees while Mrs. Haines was alive.

5. By surrendering the policy.

6. The record shows that in the case of two of the life policies the dividends were paid to the decedent's children or at their direction (R. 9a). Also, from year to year, the annual increases in the cash surrender values belonged to the assignees.

> "We accordingly see no ground for the application of section 811(c)(1)(B) * * *. It is argued by respondent that the decedent exercised the right to take income from the trust corpus. It is unquestionably true that the decedent did take such income, but *we fail to find a right on his part to do so. This result was not brought about through an exercise of a legal right on his part* but directly as a result of a failure on the part of the trustee to exercise its responsibilities as such." (Emphasis added.)

In *Burr Estate v. Commissioner*, 4 T. C. M. 1054 (1945), affirmed on another point 156 F. 2d 871 (C. A. 2, 1946) certiorari denied 329 U. S. 785 (1946), the decedent bought a house and gave it to his wife. They used it as a summer place. The Commissioner sought to include the value of the house in the decedent's estate under Section 811(c) on the theory he had retained the possession and enjoyment of it until his death. The court held the property *not* includible saying:

> "It is true that the decedent and his wife used the property as a summer home and to that extent he enjoyed the premises. The gifts were complete and after they were made, the donee had title to the real property and chattels. *The decedent retained no interest of any kind in the property and such enjoyment as he had of his gifts was at the sufferance of his wife and not because of any rights he possessed in the property.*" (Emphasis added.)

Here, even if it could be said that the decedent enjoyed "income" from the cash surrender values—which petitioners vigorously deny—it was only at the sufferance of the assignees and not because of any right she had retained and possessed in the property.

Respondent's brief (at page 21) states that the insurance part of the investment would escape estate tax unless it is taxed under Section 811(c)(1)(B). Plainly,

this is a very poor argument for asserting that the statute applies. Does the respondent intend by this that *every inter vivos* gift of property which has been subject to gift tax, and which is complete and unequivocal, also be subject to estate tax? There is no more reason for taxing a gift of the cash surrender values than an outright present gift of cash.

Respondent's argument that the entire investments—including the cash surrender values—are subject to estate tax in the decedent's estate, is further predicated on these points:

(1) The assignees did not surrender the policies (Br. p. 22).[7] Does it follow from this—as required by the statute—that Mrs. Haines *retained* an enforceable legal right to the income from the cash surrender amounts? Obviously, not.

(2) The respondent then states since the insurance was not cashed in that a "complete answer" is found here in the statutory provision requiring inclusion of the gift property if the decedent retained the income therefrom for "any period which does not in fact end before his death" (Br. p. 25). This statement offends all common sense. It first assumes that the annuity was income from the entire investment—including the cash surrender values—which is just not so. Second, how in any event could Mrs. Haines be said to have *retained* the "income" from these cash surrender amounts when (a) these amounts were *wholly* owned by the assignees, and (b) that being so, also whatever they produced as income?

(3) The respondent (Br. p. 17) likens the transaction to a deposit of a principal sum with a guaranteed

7. It is interesting to note that in a like case where the assignees actually surrendered the insurance policies during the decedent's life, the Tax Court held the insurance not includable in the decedent's gross estate. *Estate of Lillie G. Hutchinson v. Commissioner*, 20 T. C. 749 (1953).

return of approximately 2.5 percent and a guaranteed payment of principal. This statement is misleading and specious. It utterly fails, like respondent's other arguments, to address itself to the real statutory requirements.

(4) The respondent states (Br. p. 22) that Mrs. Haines' manifest intention was to make a gift at her death of the face amount of the insurance. Once again, this does not answer the statutory question whether she retained a legal right to the income from all the investment for the statutory life period.[8] Concededly, because of the loading charges and expenses, at the outset there would have been a loss if the assignees had cashed in the insurance policies, because at that time the cash surrender values were smaller than the insurance premiums, although the reverse was true prior to the decedent's death (R. 4a-5a, 11a).

Respondent's argument is irrelevant anyway. The statute is *not* based on whether the decedent intended the gift to take effect at her death or not. Another entirely different statute covers that situation, Section 811(c)(1)(C), and that Section is not applicable here.[9]

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8. The respondent misstates the facts (Br. p. 23) where it is said: "It is completely unrealistic to assume, as taxpayers do (Br. 9), that the decedent invested $384,000 to assure her beneficiaries of a cash surrender value of $289,324 in 1934, or $300,620 in 1938, or even $326,249 in 1946". Petitioners assumed no such thing. The investment of $384,000 did two things: (1) it assured the decedent of a fixed annuity for life, which the Government omits to state, as well as (2) assuring the donees of at least a certain part of the investment.

9. Section 811(c)(1)(C) of the 1939 Internal Revenue Code is *not* applicable. Mrs. Haines transferred the insurance before October 7, 1949. Section 811(c)(2) provides that even in the case of a transfer intended to take effect at or after death, if it was made before October 7, 1949, it is not includable in the decedent's gross estate unless he retained an express reversionary interest in the property, having a value immediately before his death of more than 5% of the property. Mrs. Haines did not retain any express reversionary interest in the property.

It is significant also that under the Internal Revenue Code of 1954, none of the property would be included in Mrs. Haines' gross

The controlling language of Section 811(c)(1)(B) is plain and unambiguous. It hangs on whether the decedent made a transfer "under which he has retained for his life * * * or for any period which does not in fact end before his death * * * the right to the income from the [transferred] property * * *." The words "intent" or "intend" appear nowhere in the statute. The decedent's state of mind has nothing to do with it.

Moreover, it seems clearly erroneous to say that Mrs. Haines intended *not* to make a present lifetime gift of the cash surrender values. The only reasonable assumption is that she made the assignments intending to accomplish what in fact was accomplished, giving the assignees the present right to the cash surrender amounts. Had her intent been otherwise the normal thing to do would have been merely to name the assignees as beneficiaries of the policies and *not* assign the policies to them outright.

CONCLUSION.

For the reasons stated it is respectfully submitted that the judgment of the Court below should be reversed.

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January 8, 1958.

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estate as a transfer taking effect at death under Section 2037. In order to constitute such a transfer under Section 2037 two conditions are essential: (1) possession or enjoyment must be obtainable by the beneficiaries *only* by surviving the decedent—that would *not* be the case here with respect to the cash surrender values; (2) the decedent must have retained an express reversionary interest in the property exceeding 5% of its value. As noted, the decedent retained no such reversionary interest. In speaking of the 1954 Code it is also noteworthy that the decedent's payment of the life insurance premiums would not be a ground for including the insurance in her gross estate as insurance. I. R. C. of 1954, Sec. 2042.